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ACTION EUR-12

INFO OCT-01 ISO-00 CIAE-00 DODE-00 PM-04 H-02 INR-07 L-03

NSAE-00 NSC-05 PA-01 PRS-01 SP-02 SS-15 USIA-06

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CIEP-01 LAB-04 SIL-01 OMB-01 SAJ-01 SAM-01 /088 W

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P R 201000Z FEB 76

FM AMEMBASSY PRAGUE

TO SECSTATE WASHDC PRIORITY 9651

INFO AMEMBASSY BERLIN

AMEMBASSY BUCHAREST

AMEMBASSY BUDAPEST

AMEMBASSY MOSCOW

AMEMBASSY SOFIA

AMEMBASSY WARSAW

LIMITED OFFICIAL USE SECTION 1 OR 2 PRAGUE 0449

E.O. 11652: N/A

TAGS: EEWT, CZ, XH

SUBJECT: EAST-WEST FOREIGN TRADE BOARD STUDY: THE ROLE OF
COMPENSATION ARRANGEMENTS IN EAST-WEST TRADE

REF: STATE 13648

1. EMBASSY CONSIDERS OUTLINE OF EAST-WEST FOREIGN TRADE
BOARD STUDY ON COMPENSATION ARRANGEMENTS TO BE COMPREHENSIVE
AND THOROUGH. BUT GIVEN OUR LACK OF DIRECT EXPERIENCE WITH OR
KNOWLEDGE OF SUCH ARRANGEMENTS IN CZECHOSLOVAKIA, WE ARE IN
A POOR POSITION TO SUGGEST CHANGES OR TO COMMENT (EXCEPT AS
BELOW) ON CONTENT OF PROPOSED STUDY. OUR LATENESS IN REPLYING
TO STATE 12648 WAS CAUSED BY PRAGUE FLU EPIDEMIC WHICH HAS
NOT RESPECTED NORMS OF DIPLOMATIC IMMUNITY.

2. AMONG HER EASTERN EUROPEAN NEIGHBORS, CZECHOSLOVAKIA
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HAS BEEN PROBABLY LOWEST ON LIST OF THOSE ACTIVELY ENCOURAGING
INDUSTRIAL ENTERPRISES TO SEEK COOPERATIVE PRODUCTION

AGREEMENTS WITH WESTERN FIRMS WHICH INVOLVE ELEMENTS OF COMPENSATION ARRANGEMENTS DESCRIBED REFTEL. SO FAR AS WE KNOW, THERE ARE PRACTICALLY NO COMPENSATION ARRANGEMENTS BETWEEN CZECHOSLOVAKIA AND WEST WHICH WOULD QUALIFY UNDER EITHER DEFINITION CONTAINED REFTEL. OFFICIALS INVOLVED IN FINANCING FOREIGN TRADE TOLD US THAT ONLY 20 OR 30 CZECHOSLOVAK ENTERPRISES ARE NOW ENGAGED IN SOME FORM OF "COOPERATION" WITH WESTERN FIRMS AT PRODUCTION LEVEL, BUT APPARENTLY BUYBACK, PRODUCT PAYBACK, OR JOINT MARKETING FEATURES DO NOT FIGURE PROMINENTLY IN ANY OF THEM (SEE BELOW). OFFICIALS PROFESSED IGNORANCE AS TO EXACTLY WHAT MAJORITY OF THESE ARRANGEMENTS DO ENTAIL, AND WOULD ONLY STATE THAT ENTIRE QUESTION WAS UNDER REVIEW WITHIN GOVERNMENT JUST AT THIS TIME. THEY ADDED THAT RESULTS OF STUDY WOULD NOT BE MADE KNOWN FOR ANOTHER THREE MONTHS.

3. QUERIED AS TO WHETHER THERE WERE LEGAL BARRIERS AGAINST COMPENSATION ARRANGEMENTS BETWEEN CZECHOSLOVAK PRODUCTION ENTERPRISES AND WESTERN FIRMS, OFFICIALS REPLIED THAT SUCH BARRIERS DID NOT EXIST; BUT THEY NOTED THAT ADMINISTRATIVE AND OTHER HURDLES INHERENT IN PLANNED ECONOMY; E.G., REQUIREMENT THAT PLANT MANAGERS MEET OUTPUT TARGETS EACH YEAR WITHOUT INTERRUPTION, WERE POWERFUL DISINCENTIVES IN ENCOURAGING INDUSTRIAL TRUSTS TO ACTIVELY SEEK OUT WESTERN "PARTNERS" FOR COOPERATIVE ENDEAVOR. IT BECAME CLEAR IN COURSE OF CONVERSATIONS, HOWEVER, THAT CZECHOSLOVAK GOVERNMENT IS TAKING CAREFUL LOOK AT COMPENSATION ARRANGEMENTS (THEY PREFER TERM INDUSTRIAL COOPERATION ARRANGEMENTS""ICAS) AS ONE SOLUTION TO DILEMMA POSED BY DECLINING HARD CURRENCY EXPORT RECEIPTS IN FACE OF DOMESTIC INDUSTRY'S RISING NEED FOR LARGER IN-PUTS OF WESTERN TECHNOLOGY. FOREIGN TRADE MINISTER BARCAK IN RECENT STATEMENT BEFORE PRAGUE DIPLOMATIC CORPS MADE THIS VERY CLEAR WHEN HE SAID: "AS REGARDS OUR RELATIONS WITH CAPITALIST COUNTRIES, WE SHALL STRIVE IN 1976, AND IN SUBSEQUENT YEARS AS WELL, TO EXPLOIT ALL REALISTIC POSSIBILITIES FOR EXPANDING MUTUAL ECONOMIC COOPERATION WHILE INTENDING TO PURSUE CONVENTIONAL FORMS OF GOODS EXCHANGE, WE PUT INCREASINGLY HIGH TRUST IN EXPANSION OF LIMITED OFFICIAL USE LIMITED OFFICIAL USE

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NEW METHODS OF ECONOMIC PARTNERSHIP, AMONG WHICH WE REGARD INDUSTRIAL COOPERATION AS MOST IMPORTANT." HOWEVER USEFUL AS A STATEMENT OF POLICY, BARCAK'S REMARKS SEEM NOT TO HAVE BEEN PRECEDED BY CAREFUL SPADE WORK AMONG INDUSTRY PLANNERS, ONE OF WHOM TOLD EMBOFF THAT SIGNIFICANT ICAS SHOULD NOT BE EXPECTED FOR ANOTHER THREE OR FOUR YEARS.

4. AS A COUNTRY WHICH HAS LONG BEEN CRITICIZED BY FOREIGN AND, DURING 1968 AT LEAST, DOMESTIC ECONOMISTS FOR ITS AUTARKIC APPROACH TO INDUSTRIAL DEVELOPMENT-- AND APPROACH

DICTATED LARGELY BY SOVIET POLICY DEMANDS OF EARLY 1950S --
CZECHOSLOVAKIA WOULD SEEM TO HAVE STRONG REASONS FOR
INVESTIGATING NEW APPROACHES TO TASKS OF REDUCING NUMBER OF
(MOSTLY SMALL) PLANTS AND FACTORIES IN FAVOR OF EXPANDING
FACILITIES, AND THUS ECONOMICS OF SCALE, IN THOSE INDUSTRIES
WHERE HER COMPETITIVE ADVANTAGE MIGHT STILL BE SALVAGED.
LACKING A STRONG RESEARCH AND DEVELOPMENT BASE, THERE
WOULD SEEM LITTLE POINT IN CZECHOSLOVAKIA'S CONTINUING TO
PRODUCE A RANGE OF INDUSTRIAL PRODUCTS WHICH, ACCORDING TO
GOVERNMENT STATEMENTS, APPROACHES THREE-QUARTERS OF WORLD
ASSORTMENT OF ENGINEERING PRODUCTS. THUS,
AS FOREIGN TRADE DEFICITS CONTINUE TO MOUNT, ESPECIALLY
IN HARD CURRENCIES, CZECHS HAVE BEEN FORCED TO RECONSIDER
THEIR HITHERTO CONSERVATIVE STAND ON ICAS AND CAN BE EXPECTED
TO MOVE STEADILY, IF SLOWLY, IN THIS DIRECTION AS TIME GOES ON.
IT MUST NOT BE FORGOTTEN, HOWEVER, THAT DEEP TRAUMA INDUCED
BY SOVIET-LED INVASION OF 1968 WHICH WAS BROUGHT ON IN PART

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FM AMEMBASSY PRAGUE

TO SECSTATE WASHDC PRIORITY 9652

INFO AMEMBASSY BERLIN

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BY ECONOMIC REFORMS THAT HAD APPARENTLY GONE TOO FAR
STILL ACTS AS A BRAKE ON CZECHOSLOVAK INITIATIVE IN THIS
SENSITIVE AREA. THUS, IT IS SAFE TO SAY THAT CZECHOSLOVAKIA
CAN BE COUNTED ON TO ACCEPT COMPENSATION ARRANGEMENTS WITH
WESTERN FIRMS AT A PACE SOMEWHAT SLOWER
THAN THAT OF USSR AND MOST OF HER CEMA NEIGHBORS.

5. AT PRESENT, THERE ARE NO U.S. FIRMS EITHER INVOLVED IN
OR, TO EMBASSY'S KNOWLEDGE, CONTEMPLATING INVOLVEMENT IN
COMPENSATION ARRANGEMENTS WITH CZECHOSLOVAK PRODUCTION
ENTERPRISES. WE KNOW FROM DISCUSSIONS WITH OUR WEST
GERMAN COLLEAGUES THAT AT LEAST 20 OF ABOVE-MENTIONED
COOPERATION ARRANGEMENTS IN WHICH CZECH ENTERPRISES ARE
INVOLVED WITH WESTERN FIRMS INVOLVE FRG COMPANIES. ALTHOUGH
DETAILS ARE HARD TO COME BY, WE UNDERSTAND MANY WEST
GERMAN FIRMS AGREE TO PURCHASE FROM CZECHOSLOVAKIA GOODS
WORTH A CERTAIN PERCENTAGE, USUALLY 30, OF THE VALUE OF
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WHAT THEY SELL TO CZECHS. USUALLY PRODUCTS GERMAN
FIRMS ACCEPT ARE IN NO WAY RELATED TO THOSE THEY SELL. IN
ADDITION, THEY OFTEN SELL TO ONE FTO AND BUY FROM ANOTHER.
EACH FTO HAS ITS OWN HARD CURRENCY PLAN TO FULFILL, SO A
GERMAN FIRM REPORTEDLY CANNOT COUNT WHAT IT BUYS FROM ONE
FTO AGAINST THE 30 PERCENT REQUIREMENT WITH FTO TO WHICH
IT SELLS. WE ALSO UNDERSTAND THAT MOST OF GOODS GERMAN
FIRMS ACCEPT FROM CZECHOSLOVAK ARE SOLD IN THIRD WORLD
COUNTRIES, NOT IN WEST GERMANY. ONE VENTURE, INVOLVING
PRODUCTION OF SMALL POWER MOWING MACHINES SMACKS OF A
BUYBACK ARRANGEMENT, BUT NEITHER WEST GERMAN NOR
CZECHOSLOVAK CONTACTS COULD PROVIDE DETAILS. EMBASSY
HAS REQUESTED VISIT TO CZECH ENTERPRISE CONCERNED AND
WILL REPORT WHAT CAN BE LEARNED ABOUT ARRANGEMENT, IF
AND WHEN VISIT APPROVED.

6. GIVEN PREPONDERANCE OF CZECHOSLOVAKIA'S TRADE AND
INDUSTRIAL RELATIONS WITH HER COMECON NEIGHBORS, WE DO
NOT FORESEE ICAS BECOMING MAJOR FACTOR IN ECONOMY FOR
SOME TIME TO COME. CERTAINLY, ACCORDING TO OUR SOURCES,
THERE WILL BE NO PROSPECTS FOR EQUITY INVESTMENT BY WESTERN
FIRMS IN CZECHOSLOVAK ENTERPRISES, WHATEVER GOVERNMENT
FINALLY AGREES UPON AS FRAMEWORK FOR ICA/COMPENSATION
ARRANGEMENTS. TIMING OF STUDY REPORTEDLY NOW IN PREPARATION
SUGGESTS THAT XVTH PARTY CONGRESS MAY RESULT IN SOME
FURTHER WORD ON SUBJECT.
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